LISC

Testimony of

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H.R. 3995
The Housing Affordability for America Act of 2002

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Good morning, Madam Chairwoman and members of the Subcommittee. My name is Benson Roberts. I am Vice President for Policy at the Local Initiatives Support Corporation. I appreciate the opportunity to comment on H.R. 3995, the Housing Affordability for America Act.

About LISC

LISC helps neighbors build whole communities. In 21 years, LISC and its affiliates have raised from the private sector and provided $4 billion to help over 2,000 nonprofit low-income Community Development Corporations (CDCs) across the country to produce over 110,000 affordable homes and over 14 million square feet of commercial and industrial space. We also invest major resources in jobs and income programs, childcare facilities, youth programs, crime and security initiatives and many other programs that directly benefit low-income neighborhoods and their residents. CDCs have used LISC's funding to raise over $7 billion in investment. We are deeply involved in and deeply committed to meeting the needs of low-income families and communities.

The Need for New Housing Production

LISC appreciates the Subcommittee's attention to increasing the production of affordable housing, especially for very low- and low-income families. LISC strongly supports additional federal resources for this purpose.

According to a new report from the National Housing Conference, entitled *Housing America's Working Families: A Further Exploration*, one out of every seven American households (13 million) has a critical housing need. That is, these families spend more than 50 percent of their income for housing and/or live in severely substandard conditions. This includes 3.9 million households who work the equivalent of a full time job. Rising housing costs is the primary culprit, affecting homeowners and renters in nearly equal numbers. And, critical housing needs are not just a "city problem." While four out of ten working families with critical needs live in urban areas, another four out of ten live in suburban areas (with the remainder living in non-metropolitan areas).

HUD reports that the loss of affordable rental housing is accelerating, reaching 1.14 million in just two years (1997 -1999, the most recent period for which data are available). The rental housing market continues to tighten, with rents rising faster than inflation for four consecutive years, and decreasing vacancy rates.

Only substantially more affordable housing production can reverse these trends.

How Should Capital Subsidy Funds Be Provided?

H.R. 3995 would create a new component of the HOME program to produce and preserve rental housing for very low-income families with incomes below 50% of median and extremely low-income families with incomes below 30% of median. Like the broader HOME program, Low Income Housing Tax Credits, and the proposed National Housing Trust Fund, this proposal would provide "capital subsidies" to cover some or all of the development cost. While we do not oppose either this proposal in H.R. 3995 or the Trust Fund proposal, we do not believe that a new capital subsidy program is necessary to serve very low- and extremely low-income households. What is truly needed to expand production of affordable housing substantially is to increase federal funding for this purpose substantially.

HOME already addresses the needs of very low- and extremely low-income families well. Better than two of every five HOME renters (42%) have extremely low incomes, and four of every five (82%) have very low incomes. The deep income targeting that HOME achieves is the result of local choice, not federal requirements. The HOME law requires only 20% of the rental housing to serve very low-income tenants, and there is no requirement that any of the housing reach extremely low-income tenants. The data for Housing Credits are similar, according to the General Accounting Office.

We agree with the implication of H.R. 3995 that the HOME program offers the right structure for expanding affordable housing production. Along with the Housing Credit, HOME has been an exceptionally effective housing production program. HOME is understood and supported by a broad delivery system that includes the public, for-profit, and nonprofit sectors alike. This delivery system is ready and eager to utilize additional funds quickly and well.

HOME is flexible and responsive to a wide range of local housing priorities – mostly to produce and preserve rental housing (56%), but also to assist homebuyers (26%) and to rehabilitate owner-occupied homes (19%). It is used for rehabilitation (47%), new construction (36%), acquisition (14%), and even tenant based rental assistance (3%).

Moreover, HOME operates both efficiently and effectively. HOME funds contribute an average of $15,445 per home assisted. Every HOME dollar attracts $3.95 in other funds. And, although housing development typically takes several years to plan and develop, 84% of HOME funds has been committed to specific housing activities and 72% has been disbursed. While some changes to HOME along the lines proposed in H.R. 3995 would be helpful, they are relatively minor.

The principal limitation of the HOME program is insufficient funding. HOME was originally authorized in 1990 for $2 billion in funding, equivalent to $2.9 billion in today's purchasing power. This year's appropriation of $1.85 billion is the program's highest ever, but it falls 36% short of the $2.9 billion level equivalent to what Congress authorized a dozen years ago when housing needs were not as great as they are today.

At the local level, the shortage of HOME funds means that many excellent projects cannot go forward. Not only are families not getting the housing they need, but also numerous low-income community revitalization efforts fueled by HOME cannot consolidate the hard-won but still fragile momentum they have painstakingly nurtured for years. If Congress increases HOME funding substantially, the result will be more housing production for very low- and extremely low-income families, as well as stronger and more stable communities.

The proposed provision in H.R. 3995 could add welcome new funding for housing production if the proposed funding source – recaptured Section 8 funds – proves significant. We strongly support the principle that any Section 8 funds that are recaptured should be used for affordable housing production, and not for purposes unrelated to housing, although we understand it is unclear whether these recaptures are likely to be substantial in the future. In any case, these recaptured funds could be directed to the HOME program even without a new and restricted component. More broadly, however, we urge the Subcommittee to increase the authorization level for HOME to at least $2.9 billion. Anything less would represent a retreat, at least in purchasing power, from the goal Congress set in 1990.

Adding a newly targeted component would also diminish HOME's hallmark flexibility even though states and localities have amply demonstrated their commitment to serve very low- and extremely low-income families. For example, the new component would not be available to address the needs of very low- and extremely low-income homeowners. Almost one-third (31%) of the homeowners receiving housing rehabilitation assistance though HOME have extremely low incomes, and more than two-thirds of them (69%) have very low incomes. States and localities achieve this targeting without any federal requirement to do so.

Moreover, the proposed new provision also presents several technical but nevertheless important problems.

- Funding under a new authority could not be easily combined with Low Income Housing Tax Credits. Under Section 42 (i)(2)(D) of the Internal Revenue Code, the Housing Credits available to a property are reduced to the extent they are combined with federal grants or "below-market federal loans". Section 42 (i)(2)(E) provides an exception for such loans provided under the HOME program *as in effect on August 10, 1993.* That means that funding under a newly enacted authority, even within HOME, would not qualify for the exception, and so would reduce the amount of Housing Credits available to a property.

- The maximum rent on housing receiving the new targeted funds would be based on each tenant's actual income. This formulation would generally not be acceptable to private financing sources or prudent housing sponsors, because they cannot predict in advance exactly how much revenue the housing will generate. If the tenants' incomes are lower than expected, there will not be sufficient funds to support the housing. Sponsors will be obliged to assume little or no rental income from these units, substantially driving up the amount of subsidy funds required. We believe Thrifty Production Vouchers offer a sounder way to ensure affordability to extremely low-income families.

- Under the proposal federal Housing Credits and Community Development Block Grants could be used to meet state and local matching requirements. As a result, fewer state and local funds would be made available for affordable housing than would be the case if federal funds were provided through the regular HOME program with its current matching requirements.

Most of these same comments would apply to the National Housing Trust Fund legislation introduced in the House. We would welcome some new source of funding for affordable housing production, but our preference would be to administer it through a proven program with which all participants in the affordable housing development process are already familiar and comfortable.

The Need for Thrifty Production Vouchers

LISC strongly supports the Thrifty Production Vouchers proposed in H.R. 3995.

There is a limit to what any capital subsidy program can go to serve extremely low-income families with incomes below 30% of median. Most ELI families cannot afford to pay rent high enough to carry the operating expenses of housing, even if the development cost is fully subsidized and there is no mortgage to be repaid from rents. As a result, it is not surprising that a recent HUD study found that while nearly half of all HOME-funded rental housing serves extremely low-income households, those households in this category who lack rental assistance paid an average of 69 percent of income for rent. This finding should not be read as a criticism of HOME, but a simple and unavoidable math problem. The same issue would arise for any capital subsidy program.

The solution would be to provide some form of project-based rental assistance in conjunction with capital subsidies so that housing that is produced could serve extremely low-income tenants at rents they can afford over the long term. However, Congress has been reluctant to support project-based rental subsidies.

- Unless restricted to a modest portion of a property – e.g., 25% -- these subsidies could insulate properties from the healthy discipline of having to compete for tenants in the private market. Moreover, extremely low-income tenants could be excessively concentrated within certain properties, instead of participating in more mixed-income housing. These concerns can be easily addressed by limiting the share of a property that can receive subsidies. The project-based Section 8 amendments that Congress approved in 2000 followed this approach.

- The more difficult problem is the cost of renewing rental subsidies. Appropriators understand that they will be expected to renew rental subsidies each year for an indefinite period. Even tenant-based Section 8 vouchers are expensive to renew – about $6,000 per voucher every year. As a result, appropriators are reluctant to fund incremental vouchers to begin with.

The Cost-Effectiveness of Thrifty Production Vouchers

Thrifty Production Vouchers are designed to address this cost problem. What makes a Thrifty Production Voucher different is that the "payment standard" would be the property's operating cost, instead of the housing authority's payment standard based on the Fair Market Rent (FMR) that is used for regular vouchers. Tenants would still contribute 30% of their income as rent, but since a property's operating expenses (not including mortgage payments) are generally substantially below the FMR, a Thrifty Production Voucher would cost *at least about one-third less* than a regular voucher. To the extent that the operating cost is below the maximum, which is particularly likely in areas with high FMRs, the savings will be greater. A *cap* would be set on the amount of operating expenses that could be covered, to ensure that these vouchers are less expensive than regular vouchers. H.R. 3995 proposes a cap of 75 percent of the PHA's payment standard. Units with higher costs may be assisted with regular project-based vouchers.

Based on data from properties insured by the Federal Housing Administration, HUD consultants estimated that the average per unit operating cost in 1998-2000 was $242 (in 2000 dollars). Larger units will have somewhat higher costs, but newly produced units and units in partially assisted developments will have lower costs. These data do not include taxes, utility costs, a replacement reserve, or a cash flow allowance. Even if these additional expenses were to increase the average operating cost by $200, however, this average would still be substantially less than 75 percent of the average national FY 2002 FMR for a 2-bedroom unit, which is $522.

For example, if the housing authority's payment standard, set at 100 percent of the FMR, is $700 monthly and the tenant's share of the rent and utilities is $200, a regular voucher costs $500. If the operating cost for the same property plus tenant-paid utilities is the maximum allowable, or $525, then a Thrifty Production

Voucher would cost $325, or 35 percent less than a voucher. To the extent that the operating cost is below the maximum, the savings will be greater.

Eligible operating expenses would include owner-paid utilities, contributions to reserves, an asset management fee, and a modest cash flow allowance. However, mortgage debt service costs would not be included. This means that the portion of a property with Thrifty Production Vouchers would not be able to help carry a mortgage. In some cases this means that additional capital subsidies would be needed to make projects financially feasible. But in many cases today, the nonprofit sponsors with which we work are already arranging for deep capital subsidies in order to serve extremely low-income tenants at below-market rents. In such cases, the Thrifty Production Voucher would increase the stability of the housing for tenants and sponsors alike, without necessarily adding to the capital subsidies they need. In any case, LISC strongly supports additional capital subsidies for affordable housing production.

Since subsidies would generally be limited to 25% of the units in a property, the owner could set the property's overall operating budget, limited only by the cost cap noted above. Owners would be strongly motivated to minimize operating expenses, since they would have to bear at least 75% of any unnecessary expenses.

Expenses for services (e.g., property management) performed by entities related to the property's owner, would have to be reasonable and consistent with prevailing costs in the community. Unusual operating expenses (e.g., security costs in supportive housing) would be permitted, subject to the cap.

The Attraction of Thrifty Production Vouchers

We believe that Thrifty Production Vouchers should be attractive to the various participants in the affordable housing production system.

- <u>Housing sponsors</u> could use Thrifty Production Vouchers to serve at least some extremely low-income families at affordable rents that will contribute to project stability. Serving these tenants will help sponsors to compete more effectively for allocations of Low Income Housing Tax Credits, a scarce resource rationed in part based on serving especially low-income tenants. The ability to set the operating budget should enable owners to make a long-term commitment to participate in the Thrifty Production Voucher program. Owners would not have to worry that another entity would arbitrarily set the operating budget at an unworkably low level. In the unlikely event that Congress does not renew Thrifty Production Vouchers, owners would have to meet only the income targeting requirements of other housing subsidies they receive.

- Public housing agencies could use Thrifty Production Vouchers to grow their Section 8 programs. Once allocated to properties, PHAs should find it convenient that Thrifty Production Vouchers would follow virtually all the same rules as other vouchers, except that PHAs would have to follow relatively simple steps annually to consider increases in the payment standard. Thrifty Production Vouchers also offer PHAs an opportunity to participate more fully in housing production efforts.

- State and local agencies that administer HOME, Housing Credits or other capital subsidies should welcome the availability of Thrifty Production Vouchers as a valuable tool to serve extremely low-income tenants in new and rehabilitated housing.

- Investors and lenders should be comfortable with Thrifty Production Vouchers. Although Thrifty Production Vouchers would not add to the cash flow available to pay debt service, they should add financial stability to properties that serve extremely low-income tenants, thereby reducing risks.

Other Issues with Thrifty Production Vouchers

Thrifty Production Vouchers should work especially well in tight housing markets, but they would also be valuable wherever affordable housing production is appropriate. For example, housing production plays a key role in stimulating the revitalization of low-income communities. CDCs and other housing sponsors will want to ensure that at least some of the housing produced in low-income communities can be available and affordable to extremely low-income residents of those communities, and Thrifty Production Vouchers would make this possible. Likewise, the rehabilitation of deteriorated housing or the production of housing for large families, the elderly, the disabled, or other special populations can be important even in markets where there is not a general housing shortage. In these cases too, Thrifty Production Vouchers can ensure that subsidized housing developments can accommodate at least some extremely low-income tenants.

Thrifty Production Vouchers have been designed to harness private market incentives to work efficiently, but it will be necessary to prevent possible abuse in some cases.

- One concern relates to the exceptional cases eligible for assistance on more than 25% of the units in a property (housing for the elderly, disabled, or provided with supportive services).   In these cases, the strong motivation for sponsors to manage operating expenses carefully will not apply, and greater scrutiny of operating budgets will be necessary.

- A second concern relates to operating expenses, such as property management fees, paid to the property's owner or a related party. Here, again, the normal incentive to manage costs carefully may not apply.

However, this is a common issue in affordable housing, and close cooperation between PHAs and state and local administrators of capital subsidies can ensure that such payments are in line with local norms.

On the whole, however, Thrifty Production Vouchers are conceptually sound and would add an important policy tool that no other program currently provides.

Conclusion

This concludes my testimony. I would be pleased to answer any questions you may have.